

Business leagues; insurance companies; medical malpractice insurance. A nonprofit association of insurance companies that provides medical malpractice insurance to health care providers is not exempt under section 501(c)(6) of the Code as a business league. Rev. Rul. 71-155 distinguished.

ISSUE

Does the nonprofit organization described below qualify for exemption from federal income tax under section 501(c)(6) of the Internal Revenue Code?

FACTS

The organization was created as a nonprofit association by an act of the state legislature for the purpose of making available necessary medical malpractice insurance to doctors, nurses, hospitals, and other medical providers in the state. Membership in the organization is mandatory for all insurance companies providing certain types of liability insurance in the state. Under the state statute, the term 'medical malpractice insurance' means insurance coverage against the legal liability of the insured for loss, damage, or expense incident to a claim arising out of the death or injury of any person as the result of negligence or malpractice in rendering professional services by a health care provider.

The organization was created to sell medical malpractice insurance, so long as that type of insurance is not available from for-profit insurers in the state. Any health care provider in the state is entitled to apply to the organization for coverage subject to statutorily mandated dollar limitations. Upon receipt of the requisite premium from the health care provider, the organization issues an insurance policy to such provider. The organization underwrites such insurance and adjusts or pays losses with respect thereto.

Policy rates are set to meet only losses and expenses. Policyholders receive refunds to the extent that a profit arises. Any net loss is shared proportionally by the member companies. Each company's assessment is based on the company's share of all liability insurance written in the state during the prior year.

LAW

Section 501(c)(6) of the Code provides for the exemption from federal income tax of business leagues not organized for profit, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(6)-1 of the Income Tax Regulations provides that a business league is an association of persons having some

common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. The activities of the organization must be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for profit, even though the business is conducted on a cooperative basis or produces only sufficient income to be self-sustaining, is not a business league.

ANALYSIS

The organization is formed for the purpose of, and has as its sole activity, the provision of medical malpractice insurance. Although its rates are not designed for profit, the organization charges fees, issues policies, and performs administrative services typical of insurance companies' normal operation. It is the nature of this activity that determines whether it is a business ordinarily carried on for profit. Since the provision of medical malpractice insurance is a business of a kind ordinarily carried on for profit, the organization is not operated as a business league within the requirements of section 1.501(c)(6)-1 of the regulations.

Equally important, since the organization's method of operation involves it in its member companies' insurance business, and since the organization's insurance activities serve as an economy or convenience in providing necessary protection to its policyholders engaged in providing health care, the organization is performing particular services for its member companies and policyholders. See *Associated Master Barbers & Beauticians of America, Inc., v. Commissioner*, 69 T.C. 53 (1977).

Rev. Rul. 71-155, 1971-1 C.B. 152, is distinguishable. In Rev. Rul. 71-155, a state-mandated association composed of all insurance companies writing a specified type of insurance in a given state was formed for the purpose of making insurance available to all persons in high-risk categories. The organization operated by accepting applications, and then assigning them to a member company, which performed the actual insurance functions. Unlike the organization in this case, the organization described in Rev. Rul. 71-155 did not assume the risk on a policy, and therefore was not itself engaged in the insurance business.

Compare Rev. Rul. 81-175, page 15, this Bulletin, which holds that an association that is composed of insurance companies within a given state, and that accepts for reinsurance high-risk customers who would ordinarily be turned down by member companies, is engaged in the operation of a business ordinarily carried on for profit, performs particular services for its members, and therefore is not exempt under section 501(c)(6) of the Code.

HOLDING

The organization described above does not qualify for exemption from federal income tax under section 501(c)(6) of the Code.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 71-155 is distinguished.